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SIPDIS

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TAGS: EINV ENRG EFIN TU
SUBJECT: FULL STEAM AHEAD ON TURKISH PRIVATIZATION

Ref: (A) Ankara 455

¶1. (SBU) Summary: The Privatization Administration (PA) has already realized USD 8 billion in cash proceeds from privatizations in 2006, with several profitable sales still in the pipeline for this year. Initial public offerings are planned for several state-owned enterprises and a new wave of privatizations is on the horizon, leading the PA to believe that proceeds from privatization could total nearly USD 16 billion by year-end. Although some government agencies and private interest groups continue to resist privatization, the overnment remains committed to privatization, recognizing the importance of liberalization of the economy and getting the government out of commercial activities. End summary.

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IPO PLANNED FOR AIRLINE, PETKIM, AND TURK TELEKOM
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¶2. (SBU) At the end of 2004, Turkish Airlines (THY) privatized 24.5 percent of its shares in an initial public offering (IPO). According to Privatization Administration (PA) Vice President Osman Ilter, the PA is currently waiting for the Prime Minister's approval for a second IPO to privatize an additional 26 percent of the shares by the end of May. Ilter noted that after the second IPO is completed, the PA plans to conduct a block sale of the remaining THY shares.

¶3. (SBU) In April 2005, the PA sold 38.5 percent of Petkim in an IPO, and it plans to sell an additional 11 percent in 2006 to bring the total state-owned shares under 50 percent. Ilter described a series of problems with Petkim, particularly competition from foreign imports and a profit margin squeeze from higher oil prices. The PA nevertheless hopes to take advantage of its recent leasing of land at Petkim "supersites" to increase interest in purchasing company shares.

¶4. (SBU) In an effort to make THY and Petkim more attractive to potential bidders, Ilter told us the PA plans to reduce the state share for both companies to less than 50 percent before conducting a block sale. Ilter and other PA officials have stressed that having a state share larger than 50 percent is a major impediment to efficient management of these businesses. When a company is majority state-owned, it is subject to cumbersome public procurement regulation, and all investment comes under the public investment budget,

which has been constrained by fiscal austerity under the IMF program. In addition, these companies currently have a large number of employees with costly public-sector benefit compensation packages and privileges that may discourage potential bidders.

¶5. (SBU) In 2005, the PA sold 55 percent of Turk Telekom (TT) through a block sale to Oger Telekom for USD 6.55 billion. Oger paid the first installment of the transaction, USD 1.31 billion, in November and the remaining amount is due by mid 2006. The PA still owns 45 percent of TT and recently contracted financial advisory companies to launch an IPO for the remaining shares. PA's TT Project Group Head, Gunden Cinar, told us that it was not determined what percentage of the remaining shares would be sold in the IPO, which expected take place in 2006.

OPPOSITION TO ERDEMIR SALE DWINDLES

¶6. (SBU) In December 2005, the High Board of Privatization (OIB) approved the sale of a 46.12 percent stake in Turkey's largest steel maker, Erdemir, to the military pension fund Oyak. PA Vice President Hasan Koktas told us that while the PA did not require that bidders on Erdemir have steel sector experience, they included a clause in the sale that allowed Oyak to enter into a joint venture with steel maker Arcelor in order to bring in a sectoral specialist. Koktas told us that local opposition to the Erdemir privatization has died down recently.

PA OPTIMISTIC ABOUT TUPRAS RULING

¶7. (SBU) On February 2, the Council of State (Danistay) Administrative Court halted the enforcement of the sale of 51 percent of oil refiner Turpas shares to a Koc Holding-Shell consortium (ref A). The 13th Chamber of the Danistay reviewed the case again on April 25, and said that it would announce its decision within 15 days of the Court date. Koktas believes that Danistay's 13th Chamber will rule in favor of the transaction.

TEKEL ASSET TENDER SET FOR MAY

¶8. (SBU) Koktas told us that the PA will launch a new tender process in May to sell many of tobacco maker Tekel's trademarks, factories, and inventories. The company's real estate would not be part of the deal. Koktas said that taxation is a key issue in any tobacco privatization, as 75 percent of the retail price is tax. He mentioned that in Morocco and Indonesia, the government committed to hold the taxation of cigarettes at a constant rate for several years in order to make the sale of the state-owned tobacco company more attractive to potential bidders. Koktas said he was not sure whether Turkish officials would follow the same policy. Though Koktas downplayed the problems, press is reporting that Tekel's market share has collapsed over the past 12 to 18 months, falling from around two-thirds of the market to one-third. The reasons seem to be a combination of poor management, counterfeit cigarettes from Iraq and other countries, and aggressive competition from private tobacco companies.

ENERGY PRIVATIZATION ON THE HORIZON

¶9. (SBU) PA Vice President Osman Demirci told us that the electricity distribution sale is underway but he could not be specific about a timeframe, as the key step in the process is passage of related legislation in Parliament. Demirci said that all underlying documents are ready and will be shared one-on-one with investors, but will not be made public. (Note: American firm AES had pushed for the opportunity to review and comment on key sale documents.) He said the tariff system and the equalization mechanism is almost fully complete and ready to share with investors. While Demirci said that the law's 50 percent limit on foreign control would not be a problem, it is still an unsettled issue. Both the PA and the GOT are committed to energy privatization, but the process is complex, as the interests of the Ministry of Energy, the regulator EMRA, the transmission company TEIAS, the trading company TETAS, and the investors all must be coordinated.

STATE BANK PRIVATIZATION FINALLY MOVING?

¶10. (SBU) After two different false starts and many delays in recent years, the promised privatization of Turkey's large state-owned banks seems finally to be making progress. Unlike other state companies, the state bank privatizations will be managed by a troika of the PA, Treasury and each Bank's management team. The World Bank's chief local economist is hopeful that the process is finally moving forward. PA VP Koktas confirmed that the Government had selected a consortium of investment banks, including Goldman Sachs, to propose a strategy for the sale of Halk Bank. Under the Terms of Reference for the investment bankers, negotiated with the World Ban, the bankers have wide latitude as to the type of privatization they can propose and will be compensated in part in proportion of the cash proceeds from the privatization. Koktas was optimistic the sale could go forward by year-end. The strengthening of state bank balance sheets, the reduction in interest rates and government borrowing,

and the strong foreign appetite for Turkish bank acquisitions have combined to sharply improve the prospects for state bank privatization. The Government's strategy is to first privatize the more manageable Halk Bank, before moving on next year to the more challenging privatization of Ziraat Bank, a much larger institution.

THE NEXT WAVE

¶11. (SBU) There are still quite a few state-owned companies waiting to be sold, including electricity production companies, sugar factories, steel, energy, iron and copper factories, and the remaining shares in THY, Petkim, and Turk Telekom. Koktas told us that the PA has whittled its list of companies in the initial privatization portfolio from 80 down to 10, and is now proposing adding new companies to the list of those destined for privatization. Koktas said that in proposing taking over a new set of companies, the PA has run into resistance from other government agencies that oversee or regulate the companies. Koktas noted that other agencies cannot say that they are against privatization, as it is government policy - rather, these agencies say that they will go through with privatization but then drag their heels and delay the process.

COMMENT

¶12. (SBU) In a refreshing change from most local discussion of the merits of privatization, Koktas told us that the most important reason to privatize is to liberalize the economy and get the government out of commercial activities. He believes the Government leaders agree, but have to point to the cash proceeds of the sales in their public comments - otherwise Turks would suspect state assets are being sold too cheaply. He noted that the PA has realized USD 8 billion in cash proceeds from privatizations so far this year, which is equivalent to the total receipts received in the last 20 years. He believes that several large deals - including the THY and Petkim IPOs, the Izmir port deal, the sugar factory privatizations, and the privatization of at least two electricity distribution companies - could be completed by the end of 2006, meaning that profits could double by year-end.

WILSON